

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

(f) Special rule where taxpayer takes delivery

Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

- (1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and
- (2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset.

(Added Pub. L. 106-170, title V, §534(a), Dec. 17, 1999, 113 Stat. 1931; amended Pub. L. 108-357, title IV, §413(c)(23), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 110-172, §11(a)(23), (24)(B), Dec. 29, 2007, 121 Stat. 2486.)

AMENDMENTS

2007—Subsec. (c)(2)(G). Pub. L. 110-172 substituted “subsection (d)” for “subsection (e)” and inserted “and” at end.

2004—Subsec. (c)(2)(H) to (J). Pub. L. 108-357 redesignated subpar. (J) as (H) and struck out former subpars. (H) and (I), which included foreign personal holding company and foreign investment company (as defined in section 1246(b)) within definition of “pass-thru entity”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE

Pub. L. 106-170, title V, §534(c), Dec. 17, 1999, 113 Stat. 1934, provided that: “The amendments made by this section [enacting this section] shall apply to transactions entered into after July 11, 1999.”

PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

Subpart

- A. Original issue discount.
- B. Market discount on bonds.
- C. Discount on short-term obligations.
- D. Miscellaneous provisions.

AMENDMENTS

1986—Pub. L. 99-514, title XVIII, §1899A(72), Oct. 22, 1986, 100 Stat. 2963, inserted “on bonds” after “discount” in item for subpart B.

SUBPART A—ORIGINAL ISSUE DISCOUNT

- Sec. 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments.
- 1272. Current inclusion in income of original issue discount.
- 1273. Determination of amount of original issue discount.
- 1274. Determination of issue price in the case of certain debt instruments issued for property.
- 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.
- 1275. Other definitions and special rules.

AMENDMENTS

1985—Pub. L. 99-121, title I, §102(d), Oct. 11, 1985, 99 Stat. 509, added item 1274A.

§ 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments

(a) General rule

For purposes of this title—

(1) Retirement

Amounts received by the holder on retirement of any debt instrument shall be considered as amounts received in exchange therefor.

(2) Ordinary income on sale or exchange where intention to call before maturity

(A) In general

If at the time of original issue there was an intention to call a debt instrument before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to—

- (i) the original issue discount, reduced by
- (ii) the portion of original issue discount previously includible in the gross income of any holder (without regard to subsection (a)(7) or (b)(4) of section 1272 (or the corresponding provisions of prior law)),

shall be treated as ordinary income.

(B) Exceptions

This paragraph (and paragraph (2) of subsection (c)) shall not apply to—

- (i) any tax-exempt obligation, or
- (ii) any holder who has purchased the debt instrument at a premium.

(3) Certain short-term Government obligations

(A) In general

On the sale or exchange of any short-term Government obligation, any gain realized which does not exceed an amount equal to the ratable share of the acquisition discount shall be treated as ordinary income.

(B) Short-term Government obligation

For purposes of this paragraph, the term “short-term Government obligation” means any obligation of the United States or any of its possessions, or of a State or any political

subdivision thereof, or of the District of Columbia, which has a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation.

(C) Acquisition discount

For purposes of this paragraph, the term “acquisition discount” means the excess of the stated redemption price at maturity over the taxpayer’s basis for the obligation.

(D) Ratable share

For purposes of this paragraph, except as provided in subparagraph (E), the ratable share of the acquisition discount is an amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date the taxpayer acquired the obligation and up to (and including) the date of its maturity.

(E) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the acquisition discount is the portion of the acquisition discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the taxpayer’s yield to maturity based on the taxpayer’s cost of acquiring the obligation, and
- (ii) compounding daily.

An election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(4) Certain short-term nongovernment obligations

(A) In general

On the sale or exchange of any short-term nongovernment obligation, any gain realized which does not exceed an amount equal to the ratable share of the original issue discount shall be treated as ordinary income.

(B) Short-term nongovernment obligation

For purposes of this paragraph, the term “short-term nongovernment obligation” means any obligation which—

- (i) has a fixed maturity date not more than 1 year from the date of the issue, and
- (ii) is not a short-term Government obligation (as defined in paragraph (3)(B) without regard to the last sentence thereof).

(C) Ratable share

For purposes of this paragraph, except as provided in subparagraph (D), the ratable share of the original issue discount is an amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date of original issue and up to (and including) the date of its maturity.

(D) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the original issue discount is the portion of the original issue discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the yield to maturity based on the issue price of the obligation, and
- (ii) compounding daily.

Any election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(b) Exception for certain obligations

(1) In general

This section shall not apply to—

- (A) any obligation issued by a natural person before June 9, 1997, and
- (B) any obligation issued before July 2, 1982, by an issuer which is not a corporation and is not a government or political subdivision thereof.

(2) Termination

Paragraph (1) shall not apply to any obligation purchased (within the meaning of section 1272(d)(1)) after June 8, 1997.

(c) Special rule for certain obligations with respect to which original issue discount not currently includible

(1) In general

On the sale or exchange of debt instruments issued by a government or political subdivision thereof after December 31, 1954, and before July 2, 1982, or by a corporation after December 31, 1954, and on or before May 27, 1969, any gain realized which does not exceed—

- (A) an amount equal to the original issue discount, or
- (B) if at the time of original issue there was no intention to call the debt instrument before maturity, an amount which bears the same ratio to the original issue discount as the number of complete months that the debt instrument was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered as ordinary income.

(2) Subsection (a)(2)(A) not to apply

Subsection (a)(2)(A) shall not apply to any debt instrument referred to in paragraph (1) of this subsection.

(3) Cross reference

For current inclusion of original issue discount, see section 1272.

(d) Double inclusion in income not required

This section and sections 1272 and 1286 shall not require the inclusion of any amount previously includible in gross income.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 531; amended Pub. L. 99-514, title XVIII, §1803(a)(1)(A), (2), (3), Oct. 22, 1986, 100 Stat. 2791, 2792; Pub. L. 100-647, title I,

§ 1006(u)(4), Nov. 10, 1988, 102 Stat. 3427; Pub. L. 105-34, title X, § 1003(c)(1), Aug. 5, 1997, 111 Stat. 910; Pub. L. 113-295, div. A, title II, § 221(a)(86), Dec. 19, 2014, 128 Stat. 4049.)

AMENDMENTS

2014—Subsec. (c). Pub. L. 113-295 amended subsec. (c) generally. Prior to amendment, subsec. (c) related to transition rules, including special rules for certain obligations issued before Jan. 1, 1955, and for certain obligations with respect to which original issue discount was not currently includible.

1997—Subsec. (b). Pub. L. 105-34 amended heading and text of subsec. (b) generally. Prior to amendment, text read as follows: “This section shall not apply to—

“(1) NATURAL PERSONS.—Any obligation issued by a natural person.

“(2) OBLIGATIONS ISSUED BEFORE JULY 2, 1982, BY CERTAIN ISSUERS.—Any obligation issued before July 2, 1982, by an issuer which—

“(A) is not a corporation, and

“(B) is not a government or political subdivision thereof.”

1988—Subsec. (a)(2)(A)(ii). Pub. L. 100-647 substituted “subsection (a)(7)” for “subsection (a)(6)”.

1986—Subsec. (a)(3)(B). Pub. L. 99-514, § 1803(a)(3), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “For purposes of this paragraph, the term ‘short-term Government obligation’ means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia which is—

“(i) issued on a discount basis, and

“(ii) payable without interest at a fixed maturity date not more than 1 year from the date of issue.

Such term does not include any tax-exempt obligation.”

Subsec. (a)(3)(D). Pub. L. 99-514, § 1803(a)(2)(B), inserted “except as provided in subparagraph (E).”.

Subsec. (a)(3)(E). Pub. L. 99-514, § 1803(a)(2)(A), added subpar. (E).

Subsec. (a)(4). Pub. L. 99-514, § 1803(a)(1)(A), added par. (4).

EFFECTIVE DATE OF 2014 AMENDMENT

Amendment by Pub. L. 113-295 effective Dec. 19, 2014, subject to a savings provision, see section 221(b) of Pub. L. 113-295, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title X, § 1003(c)(2), Aug. 5, 1997, 111 Stat. 911, provided that: “The amendment made by paragraph (1) [amending this section] shall apply to sales, exchanges, and retirements after the date of enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Pub. L. 98-369, div. A, title I, § 44, July 18, 1984, 98 Stat. 559, as amended by Pub. L. 98-612, § 2, Oct. 31, 1984, 98 Stat. 3182; Pub. L. 99-514, § 2, title XVIII, § 1803(b), Oct. 22, 1986, 100 Stat. 2095, 2797, provided that:

“(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this subtitle [subtitle C (§§ 41–44) of title I of div. A of Pub. L. 98-369,

enacting this section and sections 1272 to 1288 and 6706, amending sections 103A, 163, 165, 249, 341, 405, 409, 453B, 483, 751, 811, 871, 881, 1016, 1037, 1351, 1441, 6049, 7701, and 7805, and repealing sections 1232, 1232A, and 1232B of this title] shall apply to taxable years ending after the date of the enactment of this Act [July 18, 1984].

“(b) TREATMENT OF DEBT INSTRUMENTS RECEIVED IN EXCHANGE FOR PROPERTY.—

“(1) IN GENERAL.—

“(A) Except as otherwise provided in this subsection, section 1274 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by section 41) and the amendment made by section 41(b) (relating to amendment of section 483) shall apply to sales or exchanges after December 31, 1984.

“(B) Section 1274 of such Code and the amendment made by section 41(b) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(2) REVISION OF SECTION 482 REGULATIONS.—Not later than 180 days after the date of the enactment of this Act [July 18, 1984], the Secretary of the Treasury or his delegate shall modify the safe harbor interest rates applicable under the regulations prescribed under section 482 of the Internal Revenue Code of 1986 so that such rates are consistent with the rates applicable under section 483 of such Code by reason of the amendments made by section 41.

“(3) CLARIFICATION OF INTEREST ACCRUAL; FAIR MARKET VALUE RULE IN CASE OF POTENTIALLY ABUSIVE SITUATIONS.—

“(A) IN GENERAL.—

“(i) CLARIFICATION OF INTEREST ACCRUAL.—In the case of any sale or exchange—

“(I) after March 1, 1984, nothing in section 483 of the Internal Revenue Code of 1986 shall permit any interest to be deductible before the period to which such interest is properly allocable, or

“(II) after June 8, 1984, notwithstanding section 483 of the Internal Revenue Code of 1986 or any other provision of law, no interest shall be deductible before the period to which such interest is properly allocable.

“(ii) FAIR MARKET RULE.—In the case of any sale or exchange after March 1, 1984, such section 483 shall be treated as including provisions similar to the provisions of section 1274(b)(3) of such Code (as added by section 41).

“(B) EXCEPTION FOR BINDING CONTRACTS.—

“(i) Subparagraph (A)(i)(I) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(ii) Subparagraph (A)(i)(II) shall not apply to any sale or exchange pursuant to a written contract which was binding on June 8, 1984, and at all times thereafter before the sale or exchange.

“(C) INTEREST ACCRUAL RULE NOT TO APPLY WHERE SUBSTANTIALLY EQUAL ANNUAL PAYMENTS.—Clause (i) of subparagraph (A) shall not apply to any debt instrument with substantially equal annual payments.

“(4) SPECIAL RULES FOR SALES AFTER DECEMBER 31, 1984, AND BEFORE JULY 1, 1985.—

“(A) IN GENERAL.—In the case of any sale or exchange after December 31, 1984, and before July 1, 1985, of property other than new section 38 property—

“(i) sections 483(c)(1)(B) and 1274(c)(3) of the Internal Revenue Code of 1986 shall be applied by substituting the testing rate determined under subparagraph (B) for 110 percent of the applicable Federal rate determined under section 1274(d) of such Code, and

“(ii) sections 483(b) and 1274(b) of such Code shall be applied by substituting the imputation rate determined under subparagraph (C) for 120 percent of the applicable Federal rate determined under section 1274(d) of such Code.

“(B) TESTING RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The testing rate determined under this subparagraph is the sum of—

“(I) 9 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 110 percent of the applicable Federal rate determined under section 1274(d) of such Code over 9 percent.

“(C) IMPUTATION RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The imputation rate determined under this subparagraph is the sum of—

“(I) 10 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 120 percent of the applicable Federal rate determined under section 1274(d) of such Code over 10 percent.

“(D) BORROWED AMOUNT.—For purposes of this paragraph, the term ‘borrowed amount’ means the stated principal amount.

“(E) AGGREGATION RULES.—For purposes of this paragraph—

“(i) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as one sale or exchange, and

“(ii) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as one debt instrument.

“(F) CASH METHOD OF ACCOUNTING.—In the case of any sale or exchange before July 1, 1985, of property (other than new section 38 property) used in the active business of farming and in which the borrowed amount does not exceed \$2,000,000—

“(i) section 1274 of the Internal Revenue Code of 1986 shall not apply, and

“(ii) interest on the obligation issued in connection with such sale or exchange shall be taken into account by both buyer and seller on the cash receipts and disbursements method of accounting.

The Secretary of the Treasury or his delegate may by regulation prescribe rules to prevent the mismatching of interest income and interest deductions in connection with obligations on which interest is computed on the cash receipts and disbursements method of accounting.

“(G) CLARIFICATION OF APPLICATION OF THIS PARAGRAPH, ETC.—This paragraph and paragraphs (5), (6), and (7) shall apply only in the case of sales or exchanges to which section 1274 or 483 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by section 41) applies.

“(5) GENERAL RULE FOR ASSUMPTIONS OF LOANS.—Except as provided in paragraphs (6) and (7), if any person—

“(A) assumes, in connection with the sale or exchange of property, any debt obligation, or

“(B) acquires any property subject to any debt obligation,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall apply to such debt obligation by reason of such assumption (or such acquisition).

“(6) EXCEPTION FOR ASSUMPTIONS OF LOANS MADE ON OR BEFORE OCTOBER 15, 1984.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property, any debt obligation described in subparagraph (B) and issued on or before October 15, 1984, or

“(ii) acquires any property subject to any such debt obligation issued on or before October 15, 1984,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) OBLIGATIONS DESCRIBED IN THIS SUBPARAGRAPH.—A debt obligation is described in this subparagraph if such obligation—

“(i) was issued on or before October 15, 1984, and

“(ii) was assumed (or property was taken subject to such obligation) in connection with the sale or exchange of property (including a deemed sale under section 338 (a)) the sales price of which is not greater than \$100,000,000.

“(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to effect the purpose of this paragraph and paragraph (5), including regulations relating to tax-exempt obligations, government subsidized loans, or other instruments.

“(D) CERTAIN EXEMPT TRANSACTIONS.—The Secretary shall prescribe regulations under which any transaction shall be exempt from the application of this paragraph if such exemption is not likely to significantly reduce the tax liability of the purchaser by reason of the overstatement of the adjusted basis of the acquired asset.

“(7) EXCEPTION FOR ASSUMPTIONS OF LOANS WITH RESPECT TO CERTAIN PROPERTY.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property described in subparagraph (B), any debt obligation, or

“(ii) acquires any such property subject to any such debt obligation,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) SALES OR EXCHANGES TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply to any of the following sales or exchanges:

“(i) RESIDENCES.—Any sale or exchange of a residence by an individual, an estate, or a testamentary trust, but only if—

“(I) either—

“(aa) such residence on the date of such sale or exchange (or in the case of an estate or testamentary trust, on the date of death of the decedent) was the principal residence (within the meaning of section 1034) of the individual or decedent, or

“(bb) during the 2-year period ending on such date, no substantial portion of such residence was of a character subject to an allowance under this title [probably means the Internal Revenue Code of 1986] for depreciation (or amortization in lieu thereof) in the hands of such individual or decedent, and

“(II) such residence was not at any time, in the hands of such individual, estate, testamentary trust, or decedent, described in section 1221(1) (relating to inventory, etc.).

“(ii) FARMS.—Any sale or exchange by a qualified person of—

“(I) real property which was used as a farm (within the meaning of section 6420(c)(2)) at all times during the 3-year period ending on the date of such sale or exchange, or

“(II) tangible personal property which was used in the active conduct of the trade or busi-

ness of farming on such farm and is sold in connection with the sale of such farm, but only if such property is sold or exchanged for use in the active conduct of the trade or business of farming by the transferee of such property.

“(iii) TRADES OR BUSINESSES.—

“(I) IN GENERAL.—Any sale or exchange by a qualified person of any trade or business.

“(II) APPLICATION WITH SUBPARAGRAPH (B).—This subparagraph shall not apply to any sale or exchange of any property described in subparagraph (B).

“(III) NEW SECTION 38 PROPERTY.—This subparagraph shall not apply to the sale or exchange of any property which, in the hands of the transferee, is new section 38 property.

“(iv) SALE OF BUSINESS REAL ESTATE.—Any sale or exchange of any real property used in an active trade or business by a person who would be a qualified person if he disposed of his entire interest.

This subparagraph shall not apply to any transaction described in the last sentence of paragraph (6)(B) (relating to transaction in excess of \$100,000,000).

“(C) DEFINITIONS.—For purposes of this paragraph—

“(i) QUALIFIED PERSON DEFINED.—The term ‘qualified person’ means—

“(I) a person who—

“(aa) is an individual, estate, or testamentary trust,

“(bb) is a corporation which immediately prior to the date of the sale or exchange has 35 or fewer shareholders, or

“(cc) is a partnership which immediately prior to the date of the sale or exchange has 35 or fewer partners,

“(II) is a 10-percent owner of a farm or a trade or business,

“(III) pursuant to a plan, disposes of—

“(aa) an interest in a farm or farm property, or

“(bb) his entire interest in a trade or business and all substantially similar trades or businesses, and

“(IV) the ownership interest of whom may be readily established by reason of qualified allocations (of the type described in section 168(j)(9)(B), one class of stock, or the like).

“(ii) 10-PERCENT OWNER DEFINED.—The term ‘10-percent owner’ means a person having at least a 10-percent ownership interest, applying the attribution rules of section 318 (other than subsection (a)(4)).

“(iii) TRADE OR BUSINESS DEFINED.—

“(I) IN GENERAL.—The term ‘trade or business’ means any trade or business, including any line of business, qualifying as an active trade or business within the meaning of section 355.

“(II) RENTAL OF REAL PROPERTY.—For purposes of this clause, the holding of real property for rental shall not be treated as an active trade or business.

“(c) MARKET DISCOUNT RULES.—

“(1) ORDINARY INCOME TREATMENT.—Section 1276 of the Internal Revenue Code of 1986 (as added by section 41) shall apply to obligations issued after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date.

“(2) INTEREST DEFERRAL RULES.—Section 1277 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act in taxable years ending after such date.

“(d) RULES RELATING TO DISCOUNT ON SHORT-TERM OBLIGATIONS.—Subpart C of part V of subchapter P of chapter 1 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act [July 18, 1984].

“(e) 5-YEAR SPREAD OF ADJUSTMENTS REQUIRED BY REASON OF ACCRUAL OF DISCOUNT ON CERTAIN SHORT-TERM OBLIGATIONS.—

“(1) ELECTION TO HAVE SECTION 1281 APPLY TO ALL OBLIGATIONS HELD DURING TAXABLE YEAR.—A taxpayer may elect for his first taxable year ending after the date of the enactment of this Act [July 18, 1984] to have section 1281 of the Internal Revenue Code of 1986 apply to all short-term obligations described in subsection (b) of such section which were held by the taxpayer at any time during such first taxable year.

“(2) 5-YEAR SPREAD.—

“(A) IN GENERAL.—In the case of any taxpayer who makes an election under paragraph (1)—

“(i) the provisions of section 1281 of the Internal Revenue Code of 1986 (as added by section 41) shall be treated as a change in the method of accounting of the taxpayer,

“(ii) such change shall be treated as having been made with the consent of the Secretary, and

“(iii) the net amount of the adjustments required by section 481(a) of such Code to be taken into account by the taxpayer in computing taxable income (hereinafter in this paragraph referred to as the ‘net adjustments’) shall be taken into account during the spread period with the amount taken into account in each taxable year in such period determined under subparagraph (B).

“(B) AMOUNT TAKEN INTO ACCOUNT DURING EACH YEAR OF SPREAD PERIOD.—

“(i) FIRST YEAR.—The amount taken into account for the first taxable year in the spread period shall be the sum of—

“(I) one-fifth of the net adjustments, and

“(II) the excess (if any) of—

“(a) the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments.

“(ii) FOR SUBSEQUENT YEARS IN SPREAD PERIOD.—The amount taken into account in the second or any succeeding taxable year in the spread period shall be the sum of—

“(I) the portion of the net adjustments not taken into account in the preceding taxable year of the spread period divided by the number of remaining taxable years in the spread period (including the year for which the determination is being made), and

“(II) the excess (if any) of—

“(a) the excess of the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments, multiplied by 5 minus the number of years remaining in the spread period (not including the current year).

The excess described in subparagraph (B)(ii)(II)(a) shall be reduced by any amount taken into account under this subclause or clause (i)(II) in any prior year.

“(C) SPREAD PERIOD.—For purposes of this paragraph, the term ‘spread period’ means the period consisting of the 5 taxable years beginning with the year for which the election is made under paragraph (1).

“(D) CASH BASIS INCOME.—For purposes of this paragraph, the term ‘cash basis income’ means for any taxable year the aggregate amount which would be includible in the gross income of the taxpayer with respect to short-term obligations described in subsection (b) of section 1281 of such Code if the provisions of section 1281 of such Code did not apply to such taxable year and all prior taxable years within the spread period.

“(E) ACCRUAL BASIS INCOME.—For purposes of this paragraph, the term ‘accrual basis income’ means for any taxable year the aggregate amount includible in gross income under section 1281(a) of such Code for such a taxable year and all prior taxable years within the spread period.

“(f) TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.—Section 1288 of such Code (as added by section 41) shall apply to obligations issued

after September 3, 1982, and acquired after March 1, 1984.

“(g) REPEAL OF CAPITAL ASSET REQUIREMENT.—Section 1272 of such Code (as added by section 41) shall not apply to any obligation issued on or before December 31, 1984, which is not a capital asset in the hands of the taxpayer.

“(h) REPORTING REQUIREMENTS.—Section 1275(c) of such Code (as added by section 41) and the amendments made by section 41(c) [enacting section 6706 of this title] shall take effect on the day 30 days after the date of the enactment of this Act [July 18, 1984].

“(i) OTHER MISCELLANEOUS CHANGES.—

“(1) ACCRUAL PERIOD.—In the case of any obligation issued after July 1, 1982, and before January 1, 1985, the accrual period, for purposes of section 1272(a) of the Internal Revenue Code of 1986 (as amended by section 41(a)), shall be a 1-year period (or shorter period to maturity) beginning on the day in the calendar year which corresponds to the date of original issue of the obligation.

“(2) CHANGE IN REDUCTION FOR PURCHASE AFTER ORIGINAL ISSUE.—Section 1272(a)(6) of such Code (as so amended) shall not apply to any purchase on or before the date of the enactment of this Act [July 18, 1984], and the rules of section 1232A(a)(6) of such Code (as in effect on the day before the date of the enactment of this Act) shall continue to apply to such purchase.

“(j) CLARIFICATION THAT PRIOR EFFECTIVE DATE RULES NOT AFFECTED.—Nothing in the amendment made by section 41(a) shall affect the application of any effective date provision (including any transitional rule) for any provision which was a predecessor to any provision contained in part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (as added by section 41).”

[Amendment of section 44 of Pub. L. 98-369, set out above, by Pub. L. 98-612 (which added pars. (4) to (7) to subsec. (b)) not applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.]

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1272. Current inclusion in income of original issue discount

(a) Original issue discount on debt instruments issued after July 1, 1982, included in income on basis of constant interest rate

(1) General rule

For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount issued after July 1, 1982, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

(2) Exceptions

Paragraph (1) shall not apply to—

(A) Tax-exempt obligations

Any tax-exempt obligation.

(B) United States savings bonds

Any United States savings bond.

(C) Short-term obligations

Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

(D) Obligations issued by natural persons before March 2, 1984

Any obligation issued by a natural person before March 2, 1984.

(E) Loans between natural persons

(i) In general

Any loan made by a natural person to another natural person if—

(I) such loan is not made in the course of a trade or business of the lender, and

(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed \$10,000.

(ii) Clause (i) not to apply where tax avoidance a principal purpose

Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

(iii) Treatment of husband and wife

For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

(3) Determination of daily portions

For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

(A) the product of—

(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

(4) Adjusted issue price

For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

(A) the issue price of such debt instrument, plus

(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

(5) Accrual period

Except as otherwise provided in regulations prescribed by the Secretary, the term “accrual